Proposed statement on standards for accounting and review services: Elimination of certain references to statements on auditing standards and incorporation of appropriate guidance into statements on standards for accounting and review services; Exposure draft (American Institute of Certified Public Accountants), 2006, December 1

American Institute of Certified Public Accountants. Accounting and Review Services Committee

EXPOSURE DRAFT

PROPOSED STATEMENT ON STANDARDS FOR ACCOUNTING AND REVIEW SERVICES

ELIMINATION OF CERTAIN REFERENCES TO STATEMENTS ON AUDITING STANDARDS AND INCORPORATION OF APPROPRIATE GUIDANCE INTO STATEMENTS ON STANDARDS FOR ACCOUNTING AND REVIEW SERVICES

DECEMBER 1, 2006

Prepared by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants

Comments should be sent by electronic mail to Michael Glynn at mglynn@aicpa.org and received by May 18, 2007.

December 1, 2006

Accompanying this letter is an exposure draft of a proposed Statement on Standards for Accounting and Review Services (SSARS), *Elimination of Certain References to Statements on Auditing Standards and Incorporation of Appropriate Guidance Into Statements on Standards for Accounting and Review Services.* A summary of the significant provisions of the proposed SSARS follows this letter.

Comments or suggestions on any aspect of this exposure draft will be appreciated. To facilitate the Accounting and Review Services Committee's (ARSC's) consideration of responses, comments should refer to specific paragraphs by number and include supporting reasons for each suggestion or comment.

Written comments will become part of the public record of the AICPA and will be available for public inspection at the offices of the AICPA after June 18, 2007, for one year. Comments should be sent via electronic mail to Michael Glynn at mglynn@aicpa.org and received no later than May 18, 2007.

Sincerely,

Thomas A. Ratcliffe
Chair
Accounting and Review Services Committee

Charles E. Landes
Vice President
Professional Standards

Accounting and Review Services Committee
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SUMMARY

The attached is an exposure draft of a proposed Statement on Standards for Accounting and Review Services (SSARS) entitled *Elimination of Certain References to Statements on Auditing Standards and Incorporation of Appropriate Guidance Into Statements on Standards for Accounting and Review Services*.

WHY ISSUED AND WHAT IT DOES

The Accounting and Review Services Committee (ARSC) is aware that, in many instances, SSARSs reference the practitioner to Statements on Auditing Standards. The ARSC is further aware that, for many practitioners, compilations and reviews represent the highest level of service performed and, therefore, those practitioners may be unfamiliar with the auditing literature. The ARSC determined that it would be in the best interest of practitioners performing compilations and reviews as well as in the public interest if certain references to the auditing literature were eliminated from the SSARSs and those concepts incorporated in the SSARSs. This proposed Statement will eliminate those references to auditing literature from SSARSs and, where deemed appropriate, guidance similar to that originally referenced will be incorporated into the SSARSs.

In the process of developing the guidance in the proposed Statement, the ARSC determined that certain additional guidance should be developed for compilation and review engagements. That guidance includes, but is not limited to, the following:

- The accountant's consideration of going concern
- The accountant's consideration of adequacy of disclosure in financial statements prepared in conformity with an OCBOA
- The accountant's consideration of subsequent events

Such guidance will be developed and exposed in separate proposed Statements on Standards for Accounting and Review Services. The ARSC plans to expose such proposed Statements in the third quarter of 2007.

EFFECTIVE DATE

The proposed Statement would be effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007. Early application would be permitted.

HOW IT AFFECTS EXISTING STATEMENTS ON STANDARDS FOR ACCOUNTING AND REVIEW SERVICES

The proposed Statement would amend AR sections 100, 200, 300, and 400. In addition, the following Interpretations are anticipated to be affected:

Withdraw Interpretation No. 4, "Discovery of Information After the Date of the Accountant's Report," of AR section 100.

Amend Interpretation No. 11, "Reporting on Uncertainties" by eliminating the reference to SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* and incorporating guidance specific to compilation and review engagements.

Conform Interpretation No. 15, "Differentiating a Financial Statement Presentation From a Trial Balance," of AR section 100 by deleting the "typical titles" for financial statements and instead referencing the examples of financial statement titles included in AR section 100.04 as revised by the proposed Statement.

PROPOSED STATEMENT ON STANDARDS FOR ACCOUNTING AND REVIEW SERVICES

ELIMINATION OF CERTAIN REFERENCES TO STATEMENTS ON AUDITING STANDARDS AND INCORPORATION OF APPROPRIATE GUIDANCE INTO STATEMENTS ON STANDARDS FOR ACCOUNTING AND REVIEW SERVICES

Amendment to AR Section 100, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100.01, 100.04, 100.46 - .52, 100.63 - .71, 100.91)

1. AR section 100, *Compilation and Review of Financial Statements*, as amended, sets forth the performance and communication requirements when an accountant submits unaudited financial statements of a nonpublic entity to his or her client or to third parties. This amendment revises AR section 100 by eliminating certain references to auditing literature and, where deemed appropriate, incorporating guidance similar to that originally referenced.

2. New language is shown in boldface italics; deleted language is shown by strikethrough.

.01 This Statement sets forth the performance and communication requirements when an accountant submits unaudited financial statements of a nonpublic entity to his or her client or third parties. The accountant should not submit unaudited financial statements of a nonpublic entity to his or her client or a third party unless, as a minimum, he or she complies with the provisions of this section applicable to a compilation engagement.

a. Compilation of financial statements.[1] If the accountant performs a compilation, a communication to management is required. The type of communication depends on the following.

   1. If the accountant is engaged to report on compiled financial statements or submits financial statements to a client that are or reasonably might be expected to be used by a third party, see paragraphs .11 through .19 for reporting requirements.

   2. If the accountant submits financial statements to a client that are not reasonably expected to be used by a third party, see paragraphs .20 through .23 for required communications to management.

   In deciding whether the financial statements are or reasonably might be expected to be used by a third party, the accountant may rely on management's representation without further inquiry, unless information comes to his or her attention that contradicts management's representation.

[1] See Appendix A [paragraph .74], "Compilation of Financial Statements," for a flowchart describing the requirements of Statements on Standards for Accounting and Review Services (SSARSs) for a compilation engagement.

In each of the above circumstances, the performance requirements in paragraphs .05 and .07 through .10 apply.

b. Review of financial statements.~~[2]~~ If the accountant performs a review, see paragraphs .05 and .24 through .44 for performance and reporting requirements.

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Definitions

.04 Certain terms are defined for purposes of this Statement as follows.

Submission of financial statements. Presenting to a client or third parties financial statements that the accountant has prepared either manually or through the use of computer software.

Third party. All parties except for members of management who are knowledgeable about the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of financial statements.[4]

Nonpublic entity. Any entity other than (*a*) one whose securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally; (*b*) one that makes a filing with a regulatory agency in preparation for the sale of any class of its securities in a public market; or (*c*) a subsidiary, corporate joint venture, or other entity controlled by an entity covered by (*a*) or (*b*). (See ~~SSARS No. 2~~***AR section 200***, *Reporting on Comparative Financial Statements* ~~[section 200]~~).

Generally accepted accounting principles (GAAP). ***A technical accounting term that encompasses the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time. It includes not only broad guidelines of general application, but also detailed practices and procedures. Those conventions, rules, and procedures provide a standard by which to measure financial presentations. See Appendix J, "Sources of Generally Accepted Accounting Principles," for the hierarchy of GAAP.***

Other comprehensive basis of accounting (OCBOA). ***One of the following:***

(a) A basis of accounting that the reporting entity uses to comply with the requirements or financial reporting provisions of a governmental regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting insurance companies use pursuant to the rules of a state insurance commission).

~~[2] Statements on Auditing Standards (SASs) provide guidance to the accountant who performs services in connection with the unaudited financial statements of a public entity. However, if a public entity does not have its annual financial statements audited, an accountant may review the entity's annual or interim financial statements in accordance with SSARSs as permitted by footnote 4 of SAS No. 26, *Association With Financial Statements* [AU section 504.05].~~

[4] The accountant may wish to specify those members of management. See Appendix ~~F~~ ***D***[paragraph ~~.79~~***.104***], "Compilation of Financial Statements Not Intended For Third-Party Use – Illustrative Engagement Letter."

(b) A basis of accounting that the reporting entity uses or expects to use to file its income tax return for the period covered by the financial statements.

(c) The cash basis of accounting and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets). Ordinarily a modification would have substantial support if the method is equivalent to the accrual basis of accounting for that item, the recognition of the method is based on a cash transaction and if the method is not illogical. If modifications to the cash basis of accounting do not have substantial support, the accountant should appropriately modify his or her report in accordance with the guidance in paragraphs .45 through .47. If the modifications are so extensive that the modified "cash basis" statements are, in the accountant's judgment, equivalent to financial statements on the accrual basis, the statements should be considered GAAP basis. The accountant may use the standard form of report modified as appropriate because of the departures from generally accepted accounting principles.

(d) A definite set of criteria having substantial support that is applied to all material items appearing in financial statements (for example, the price-level basis of accounting).

Financial statement. A presentation of financial data, including accompanying notes, derived from accounting records and intended to communicate an entity's economic resources or obligations at a point in time, or the changes therein for a period of time, in accordance with GAAP[5] or ***an*** ~~a comprehensive basis of accounting other than~~ ***OCBOA.***~~.~~[6] Financial forecasts, projections and similar presentations,[7] and financial presentations included in tax returns are not financial statements for purposes of this Statement. The following financial presentations are examples of financial statements ***that are intended to present financial position, results of operations, or cash flows in conformity with generally accepted accounting principles. The following is not meant to be all-inclusive***:[8]

Balance sheet

Statement of income

Statement of comprehensive income

~~[5] The definition of GAAP and the hierarchy of established accounting principles presented in SAS No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles [AU section 411], is also applicable to compilations and reviews of financial statements performed under SSARSs.~~

[6] ~~The term *comprehensive basis of accounting other than generally accepted accounting principles* is defined in SAS No. 62, *Special Reports*, paragraph .04 [AU section 623.04]. SAS No. 62, paragraphs 9 and 10 [AU section 623.09 and .10], provides guidance on evaluating the adequacy of disclosure in financial statements prepared in conformity with an OCBOA.~~ Hereafter, reference to ***generally accepted accounting principles (***GAAP***)*** in this ~~s~~***S***tatement includes, where applicable, ~~another comprehensive basis of accounting (~~OCBOA~~)~~.

[7] Statement on Standards for Attestation Engagements No. 10, ~~c~~***C***hapter 3, *Financial Forecasts and Projections* [AT section 301], as well as the AICPA *Guide for Prospective Financial Information*, provide guidance on preparing and reporting on financial forecasts, projections, and similar presentations.

~~[8] SAS No. 62, paragraph .07 [AU section 623.07], provides guidance with respect to suitable titles for financial statements that are prepared in conformity with OCBOA other than GAAP.~~

- Statement of retained earnings
- Statement of cash flows
- Statement of changes in owners' equity
- Statement of assets and liabilities (with or without owners' equity accounts)
- Statement of operations
- Statement of revenue and expenses
- Statement of financial position ***(condition)***
- Statement of activities
- Summary of operations
- Statement of operations by product lines
- ~~Statement of cash receipts and disbursements~~

Financial statements prepared in conformity with an OCBOA should be suitably titled. Unmodified GAAP financial statement titles are not acceptable for use in OCBOA financial statements. The following financial presentations are examples of financial statements presented in conformity with an OCBOA. The following is not meant to be all-inclusive and the selection of specific financial statement titles is a matter of judgment; any modified title would fulfill the requirements of AR section 100 as long as it is clear that the financial statements are not prepared in accordance with GAAP. There is no requirement to modify standard GAAP financial statement captions (for example, net income or current assets) in OCBOA financial statements.

Balance sheet—cash basis

Statement of assets and liabilities arising from cash transactions

Statement of assets, liabilities, and stockholders' equity—income tax basis

Statement of revenue collected and expenses paid

Statement of revenue and expenses—income tax basis

Statement of income—statutory basis

Statement of operations—income tax basis

A financial statement may be, for example, that of a corporation, a consolidated group of corporations, a combined group of affiliated entities, a not-for-profit organization, a governmental entity, an estate or trust, a partnership, a proprietorship, ***a limited liability partnership (LLP), a limited liability company (LLC),*** a segment of any of these, or an individual. The method of preparation (for example, manual or computer preparation) is not relevant to the definition of a financial statement.

Compilation of financial statements. Presenting in the form of financial statements [9] information that is the representation of management (owners) without undertaking to express any assurance on the statements. (The accountant might consider it necessary to perform other accounting services to compile the financial statements. See paragraph .08.)

Review of financial statements. Performing inquiry and analytical procedures that provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the ***financial*** statements for them to be in conformity with GAAP or, if applicable, with an other comprehensive basis of accounting (OCBOA). (The accountant might consider it necessary to compile the financial statements or to perform other accounting services to enable him or her to perform a review. See paragraph .35.)

The objective of a review differs significantly from the objective of a compilation. The inquiry and analytical procedures performed in a review should provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the financial statements. No expression of assurance is contemplated in a compilation.

The objective of a review also differs significantly from the objective of an audit of financial statements in accordance with generally accepted auditing standards (GAAS). The objective of an audit is to provide a reasonable basis for expressing an opinion regarding the financial statements taken as a whole. A review does not provide a basis for the expression of such an opinion because a review does not contemplate obtaining an understanding of internal control or assessing control risk; tests of accounting records and of responses to inquiries by obtaining corroborating evidential matter through inspection, observation, or confirmation; and certain other procedures ordinarily performed during an audit. A review may bring to the accountant's attention significant matters affecting the financial statements, but it does not provide assurance that the accountant will become aware of all significant matters that would be disclosed in an audit.

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Emphasis of a Matter

.45 In any report on financial statements the accountant may emphasize a matter regarding the financial statements. Such explanatory information should be presented in a separate paragraph of the accountant's report. Emphasis paragraphs are never required; they may be added solely at the accountant's discretion.

.46 Because an emphasis of matter paragraph is used to emphasize a matter disclosed by management in the financial statements, an accountant may not include an emphasis paragraph in a compilation report on financial statements that omit substantially all disclosures unless the matter is disclosed in the financial statements.[29] Examples of matters the accountant may wish to emphasize are:

[9] Paragraphs .16 through .18 provide guidance to the accountant engaged to compile financial statements that omit substantially all the disclosures required by GAAP or OCBOA.

[29] ***For example, the accountant can include an emphasis paragraph on a matter when management has presented selected information, even though substantially all disclosures have been omitted, as long as the matter discussed in the emphasis paragraph is described in the selected information.***

Uncertainties.

That the entity is a component of a larger business enterprise.

That the entity has had significant transactions with related parties.

Unusually important subsequent events.

Accounting matters, other than those involving a change or changes in accounting principles, affecting the comparability of the financial statements with those of the preceding period.

Departures From Generally Accepted Accounting Principles

~~.45~~ ***.47*** An accountant who is engaged to compile or review financial statements may become aware of a departure from generally accepted accounting principles (which include adequate disclosure) that is material to the financial statements. (As noted previously, reference in this statement to generally accepted accounting principles includes, where applicable, another comprehensive basis of accounting.) Paragraphs .16 through .18 provide guidance to the accountant when the departure relates to the omission of substantially all disclosures in the financial statements he ***or she*** has compiled. ~~SSARS No. 3 [~~***AR*** section 300~~]~~ provides guidance when the departure is called for by a prescribed form or related instructions. In all other circumstances, if the financial statements are not revised, the accountant should consider whether modification of his standard report is adequate to disclose the departure.

~~.46~~ ***.48*** If the accountant concludes that modification of the standard report is appropriate,[30] the departure should be disclosed in a separate paragraph of the report, including disclosure of the effects of the departure on the financial statements if such effects have been determined by management or are known as the result of the accountant's procedures. The accountant is not required to determine the effects of a departure if management has not done so, provided the accountant states in the report that such determination has not been made. Examples of compilation and review reports that disclose departures from generally accepted accounting principles follow.

Compilation Report

I (we) have compiled the accompanying balance sheet of XYZ Company as of December 31, ~~19~~***20***XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any

[30] Normally, neither an uncertainty, including an uncertainty about an entity's ability to continue as a going concern, nor an inconsistency in the application of accounting principles would cause the accountant to modify the standard report provided the financial statements appropriately disclose such matters. Nothing in this statement, however, is intended to preclude an accountant from emphasizing in a separate paragraph of his or her report a matter regarding the financial statements.

other form of assurance on them. However, I (we) did become aware of a departure (certain departures) from generally accepted accounting principles that is (are) described in the following paragraph(s).

(Separate paragraph)

As disclosed in note X to the financial statements, generally accepted accounting principles require that land be stated at cost. Management has informed me (us) that the company has stated its land at appraised value and that, if generally accepted accounting principles had been followed, the land account and stockholders' equity would have been decreased by $500,000.

or

A statement of cash flows for the year ended December 31, ~~19~~***20***XX, has not been presented. Generally accepted accounting principles require that such a statement be presented when financial statements purport to present financial position and results of operations.~~[30]~~ [31]

Review Report

I (we) have reviewed the accompanying balance sheet of XYZ Company as of December 31, ~~19~~***20***XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, with the exception of the matter(s) described in the following paragraph(s), I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

(Separate paragraph)

As disclosed in note X to the financial statements, generally accepted accounting principles require that inventory cost consist of material, labor, and overhead. Management has informed me (us) that the inventory of finished goods and work in process is stated in the accompanying financial statements at material and labor cost only, and that the effects of this departure from generally accepted accounting principles on financial position, results of operations, and cash flows have not been determined.

~~[30]~~

[31] If a statement of cash flows is not presented, the first paragraph of the compilation or review report should be modified accordingly.

or

As disclosed in note X to the financial statements, the company has adopted (description of newly adopted method), whereas it previously used (description of previous method). Although the (description of newly adopted method) is in conformity with generally accepted accounting principles, the company does not appear to have reasonable justification for making a change as required by Opinion No. 20 of the Accounting Principles Board.

~~**.47**~~ ***.49*** If the accountant believes that modification of his standard report is not adequate to indicate the deficiencies in the financial statements taken as a whole, he should withdraw from the compilation or review engagement and provide no further services with respect to those financial statements. The accountant may wish to consult with his legal counsel in those circumstances.

Subsequent Discovery of Facts Existing at Date of Report

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~~**.59**~~ ***.60*** Subsequent to the date of the report on the financial statements that the accountant has compiled or reviewed, he ***or she*** may become aware that facts may have existed at that date which might have caused him ***or her*** to believe that information supplied by the entity was incorrect, incomplete, or otherwise unsatisfactory had ~~he~~ ***the accountant*** then been aware of such facts. In such circumstances, the accountant may wish to consider the guidance in ***paragraphs .61 through .67.*** ~~section 561 of Statement on Auditing Standards No. 1 [AU section 561] in determining an appropriate course of action, giving due consideration to the different objectives of compilation, review, and audit engagements. Because of the legal implications involved in actions contemplated under section 561 of SAS No. 1 [AU section 561], the accountant should consider consulting with his attorney.~~

.61 Because of the variety of conditions that might be encountered, some of the procedures contained in this section are necessarily set out only in general terms; the specific actions to be taken in a particular case may vary with the circumstances. The accountant would be well advised to consult with his or her legal counsel and insurance provider when he or she encounters the circumstances to which this section may apply because of legal implications that may be involved in actions contemplated herein.

.62 After the date of the accountant's compilation or review report, the accountant has no obligation to perform other compilation or review procedures with respect to the financial statements covered by that report, unless new information that may affect the report comes to his or her attention.

.63 When the accountant becomes aware of information that relates to financial statements previously reported on by him or her, but that was not known to him or her at the date of the accountant's compilation or review report, and that is of such a nature and from such a source that the accountant would have considered it had it come to his or her attention during the course of the compilation or review engagement, the accountant should, as soon as practicable, request that management consider the effect of the information on the previously issued financial statements. Additionally, the accountant should undertake to determine whether the facts existed at

*the date of the accountant's compilation or review report and, if so, consider the effect of the matter on such report. If the nature and effect of the matter are such that (***a***) the accountant's compilation or review report would have been affected if the information had been known to the accountant at the date of his or her report and had not been reflected in the financial statements and (***b***) the accountant believes that there are persons currently using or likely to use the financial statements who would attach importance to the information, the accountant should:*

> *In a compilation engagement, obtain additional or revised information.*
> *In a review engagement, perform the additional procedures deemed necessary to achieve limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with generally accepted accounting principles.*

*With respect to (***b***), consideration should be given, among other things, to the time elapsed since the financial statements were issued.*

*.64 When the accountant has concluded, after considering (***a***) and (***b***) in paragraph .63 as appropriate, that action should be taken to prevent further use of the accountant's compilation or review report, the accountant should advise his or her client to make appropriate disclosure of the newly discovered facts and their impact on the financial statements to persons who are known to be currently using or who are likely to use the financial statements and the related accountant's compilation or review report. When the client undertakes to make appropriate disclosure, the method used and the disclosure made will depend on the circumstances.*

- **a.** *If the effect on the financial statements or accountant's compilation or review report of the subsequently discovered information can promptly be determined, disclosure should consist of issuing, as soon as practicable, revised financial statements and accountant's compilation or review report. The reasons for the revision usually should be described in a note to the financial statements and referred to in the accountant's compilation or review report. Generally, only the most recently issued compiled or reviewed financial statements would need to be revised, even though the revision resulted from events that had occurred in prior years.* [37]

- **b.** *When issuance of financial statements accompanied by the accountant's compilation or review report for a subsequent period is imminent,* [38] *so that disclosure is not delayed, appropriate disclosure of the revision can be made in such statements instead of reissuing the earlier statements pursuant to subparagraph (***a***).* [39]

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[37] ***See paragraphs 26 and 27 of Accounting Principles Board (APB) Opinion No. 9 [AC section A35.107-.108] and paragraphs 36 and 37 of APB Opinion No. 20 [AC section A35.105] regarding disclosure of adjustments applicable to prior periods.***

[38] ***For purposes of this standard,*** **imminent** ***means within 90 days of determining the effect of the misstatement(s) on the previously issued financial statements.***

[39] ***See paragraphs 26 and 27 of Accounting Principles Board (APB) Opinion No. 9 [AC section A35.107-.108] and paragraphs 36 and 37 of APB Opinion No. 20 [AC section A35.105] regarding disclosure of adjustments applicable to prior periods.***

c. ***When the effect on the financial statements of the subsequently discovered information cannot be determined, the issuance of revised financial statements and accountant's compilation or review report would necessarily be delayed. In this circumstance, when it appears that the information will require a revision of the statements, appropriate disclosure would consist of notification by the client to persons who are known to be using or who are likely to use the financial statements and the related accountant's compilation or review report that they should not be used, and that revised financial statements and accountant's compilation or review report will be issued as soon as practicable.***

.65 The accountant should take whatever steps he or she deems necessary to satisfy himself or herself that the client has made the disclosures specified in paragraph .64. Although a compilation report does not express any form of assurance on the financial statements, it would seldom be appropriate for an accountant to conclude, simply because his or her responsibilities were limited to a compilation service, that notification of third party users in the absence of notification by the client is not required when the accountant knows that the financial statements should be revised.

.66 If the client refuses to make the disclosures specified in paragraph .64, the accountant should notify the appropriate personnel at the highest levels within the entity, such as the manager (owner) or the board of directors, of such refusal and of the fact that, in the absence of disclosure by the client, the accountant will take steps as outlined below to prevent further reliance upon his or her report. The steps that can appropriately be taken will depend upon the degree of certainty of the accountant's knowledge that there are persons who are currently using or who will use the financial statements and the accountant's compilation or review report, and who would attach importance to the information, and the accountant's ability as a practical matter to communicate with them. Unless the accountant's attorney recommends a different course of action, the accountant should take the following steps to the extent applicable:

a. ***Notification to the client that the accountant's compilation or review report must no longer be associated with the financial statements.***

b. ***Notification to the regulatory agencies having jurisdiction over the client that the accountant's compilation or review report should no longer be used.***

c. ***Notification to each person known to the accountant to be using the financial statements that his or her report should no longer be used. In many instances, it will not be practicable for the accountant to give appropriate individual notification to stakeholders, whose identities ordinarily are unknown to him or her; notification to a regulatory agency having jurisdiction over the client will usually be the only practicable way for the accountant to provide appropriate disclosure. Such notification should be accompanied by a request that the agency take whatever steps it may deem appropriate to accomplish the necessary disclosure.***

.67 The following guidelines should govern the content of any disclosure made by the accountant in accordance with paragraph .66 to persons other than his or her client:

a. ***The disclosure should include a description of the nature of the subsequently acquired information and its effect on the financial statements.***

b. ***The information disclosed should be as precise and factual as possible and should not go beyond that which is reasonably necessary to accomplish the purpose mentioned in the preceding subparagraph (a). Comments concerning the conduct or motives of any person should be avoided.***

If the client has not cooperated, the accountant's disclosure need not detail the specific information but can merely indicate that information has come to his or her attention which the client has not cooperated in attempting to substantiate and that, if the information is true, the accountant believes that the compilation or review report must no longer be relied upon or be associated with the financial statements. No such disclosure should be made unless the accountant believes that the financial statements are likely to be misleading and that the accountant's compilation or review report should not be relied upon.

Appendix F

Review of Financial Statements—Illustrative Representation Letter

~~.79~~ .87

A review of financial statements consists principally of inquiries of company personnel and analytical procedures applied to financial data. As part of a review of financial statements, the accountant is required to obtain a written representation from his or her client to confirm the oral representations made to the accountant. The introductory paragraph should specify the financial statements and periods covered by the accountant's review report, for example, "balance sheets of XYZ Company as of December 31, 20X1 and 20X0, and the related statements of income and retained earnings, and cash flows for the years then ended."

If matters exist that should be disclosed to the accountant, they should be indicated by listing them following the representation. For example, if an event subsequent to the date of the balance sheet has been disclosed in the financial statements, the subsequent events paragraph could be modified as follows: "To the best of our knowledge and belief, except as discussed in Note X to the financial statements, no events have occurred. . . ." Similarly, in appropriate circumstances, item 4 could be modified as follows: "The company has no plans or intentions that may materially affect the carrying value or classification of assets and liabilities, except for our plans to dispose of Segment A, as disclosed in Note X to the financial statements, which are discussed in the minutes of the December 7, 20X1, meeting of the board of directors."

The following representation letter is included for illustrative purposes only. The accountant may decide, based on the circumstances of the review engagement or the industry in which the entity operates, that other matters should be specifically included in the letter or that some of the representations included in the illustrative letter are not necessary.

(Date[1])
(To the Accountant)

[1] This date should be the date that the letter is presented and signed by the client. In no event should the letter be presented and signed prior to the completion of the review.

We are providing this letter in connection with your review of the (identification of financial statements, e.g. balance sheets and related statements of income and retained earnings, and cash flows) of (name of entity) as of (dates e.g. December 31, 20X1 and December 31, 20X2) and for the (periods of review e.g. for the years then ended) for the purpose of expressing limited assurance that there are no material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles. We confirm that we are responsible for the fair presentation in the financial statements of financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person ***using*** the information would be changed or influenced by the omission or misstatement.[2]

We confirm, to the best of our knowledge and belief, [as of (the date of the accountant's review report)] the following representations made to you during your review.

1. The financial statements referred to above are fairly presented in conformity with generally accepted accounting principles.

2. We have made available to you all:

   a. Financial records and related data.

   b. Minutes of the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared.

3. There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements.

4. We acknowledge our responsibility to prevent and detect fraud.

5. We have no knowledge of any fraud or suspected fraud affecting the entity involving management or others where the fraud could have a material effect on the financial statements, including any communications received from employees, former employees or others.

6. We have no plans or intentions that may materially affect the carrying amounts or classification of assets and liabilities.

7. There are no material losses (such as from obsolete inventory or purchase or sales commitments) that have not been properly accrued or disclosed in the financial statements.

8. There are no:

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[2] The qualitative discussion of materiality used in this letter is adapted from Financial Accounting Statements Board Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information*.

a. Violations or possible violations of laws or regulations, whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency

b. Unasserted claims or assessments that our lawyer has advised us are probable of assertion that must be disclosed in accordance with Financial Accounting Standards Board (FASB) Statement No. 5 [AC section C59], Accounting for Contingencies.[3]

c. Other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB Statement No. 5

9. The company has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets, nor has any asset been pledged as collateral.

10. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.

11. The following have been properly recorded or disclosed in the financial statements:

a. Related party transactions, including sales, purchases, loans, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties.

b. Guarantees, whether written or oral, under which the company is contingently liable.

c. Significant estimates and material concentrations known to management that are required to be disclosed in accordance with the AICPA's Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*. [Significant estimates are estimates at the balance sheet date that could change materially with the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets or geographic areas for which events could occur that would significantly disrupt normal finances within the next year.]

[*Add additional representations that are unique to the entity's business or industry. See below for additional illustrative representations.*]

12. We are in agreement with the adjusting journal entries you have recommended, and they have been posted to the company's accounts. (if applicable)

13. To the best of our knowledge and belief, no events have occurred subsequent to the balance-sheet date and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements.[4]

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[3] If management has not consulted a lawyer regarding litigation, claims, and assessments, the representation might be worded as follows:

> We are not aware of any pending or threatened litigation, claims, or assessments or unasserted claims or assessments that are required to be accrued or disclosed in the financial statements in accordance with Financial Accounting Standards Board Statement No. 5 [AC section C59], *Accounting for Contingencies*, and we have not consulted a lawyer concerning litigation, claims, or assessments.

[4] If the accountant "dual dates" his or her report, the accountant should consider whether obtaining additional representations relating to the subsequent event is appropriate.

14. We have responded fully and truthfully to all inquiries made to us by you during your review.

____
(Name of Owner or Chief Executive Officer and Title)

____
(Name of Chief Financial Officer and Title, where applicable)

~~The following additional representations may be appropriate in certain situations. This list of additional representations is not intended to be all-inclusive. In drafting a representation letter, the effects of other applicable pronouncements should be considered.~~

- ~~The financial statements disclose all of the matters of which we are aware that are relevant to the entity's ability to continue as a going concern, including significant conditions and events, and our plans.~~

- ~~We have reviewed long-lived assets to be held and used or to be disposed of for impairment in accordance with FASB Statement No. 144, Accounting for Impairment or Disposal of Long-Lived Assets, whenever events or changes in circumstances have indicated that the carrying amount of assets might not be recoverable, and have appropriately recorded the adjustment.~~

- ~~We have tested goodwill and indefinite-lived intangibles for impairment in accordance with FASB Statement No. 142, Goodwill and Other Intangible Assets, and, when an asset has been impaired, we have appropriately recorded the adjustment to the carrying value of the impaired asset.~~

- ~~Debt securities that have been classified as held-to-maturity have been so classified due to our intent to hold such securities to maturity and our ability to do so. All other debt securities have been classified as available-for-sale or trading.~~

- ~~We consider the decline in value of debt or equity securities classified as either available-for-sale or held-to-maturity to be temporary.~~

- ~~Receivables reported in the financial statements represent valid claims against debtors for sales or other charges arising on or before the balance-sheet date and have been appropriately reduced to their estimated net realizable value.~~

- ~~We believe that the carrying amounts of all material assets will be recoverable.~~

- ~~All agreements to repurchase assets previously sold have been properly disclosed.~~

- ~~We have made provisions for losses to be sustained in the fulfillment of, or from the inability to fulfill, sales commitments.~~

~~See Statement on Auditing Standards No. 85, *Management Representations*, Appendix B, "Additional Illustrative Representations" [AU section 333.17]], for other representations that may be appropriate from management relating to matters specific to the entity's business or industry.~~

Representation letters ordinarily should be tailored to include additional appropriate representations from management relating to matters specific to the entity's business or

industry. The following is a list of additional representations that may be appropriate in certain situations. This list is not intended to be all-inclusive. The accountant should consider the effects of pronouncements issued subsequent to the issuance of this section.

General

Condition	*Illustrative Example*
The impact of a new accounting principle is not known.	*We have not completed the process of evaluating the impact that will result from adopting Financial Accounting Standards Board (FASB) Statement No. [*XXX, Name*], as discussed in Note [*X*]. The company is therefore unable to disclose the impact that adopting FASB Statement No. [*XXX*] will have on its financial position and the results of operations when such Statement is adopted.*
There is justification for a change in accounting principles.	*We believe that [***describe the newly adopted accounting principle***] is preferable to [***describe the former accounting principle***] because [***describe management's justification for the change in accounting principles***].*
Financial circumstances are strained, with disclosure of management's intentions and the entity's ability to continue as a going concern.	*Note [*X*] to the financial statements discloses all of the matters of which we are aware that are relevant to the company's ability to continue as a going concern, including significant conditions and events, and management's plans.*
The possibility exists that the value of specific significant long-lived assets or certain identifiable intangibles may be impaired.	*We have reviewed long-lived assets and certain identifiable intangibles to be held and used for impairment whenever events or changes in circumstances have indicated that the carrying amount of its assets might not be recoverable and have appropriately recorded the adjustment.*
The entity has a variable interest in another entity.	*Variable interest entities (VIEs) and potential VIEs and transactions with VIEs and potential VIEs have been properly recorded and disclosed in the financial statements in accordance with GAAP.* *We have considered both implicit and explicit variable interests in (*a*) determining whether potential VIEs should be considered VIEs, (*b*) calculating expected losses and residual returns, and (*c*) determining which party, if any, is the primary beneficiary.* *We have provided you with lists of all identified variable interests in (*a*) VIEs, (*b*) potential VIEs that we considered but judged not to be VIEs, and (*c*) entities that were afforded the scope exceptions of FASB Interpretation (FIN) No. 46R,* **Consolidation of Variable Interest Entities.**

	We have advised you of all transactions with identified VIEs, potential VIEs, or entities afforded the scope exceptions of FIN No. 46R. *We have made available all relevant information about financial interests and contractual arrangements with related parties, de facto agents, and other entities, including but not limited to, their governing documents, equity and debt instruments, contracts, leases, guarantee arrangements, and other financial contracts and arrangements.* *The information we provided about financial interests and contractual arrangements with related parties, de facto agents, and other entities includes information about all transactions, unwritten understandings, agreement modifications, and written and oral side agreements.* *Our computations of expected losses and expected residual returns of entities that are VIEs and potential VIEs are based on the best information available and include all reasonably possible outcomes.* *Regarding entities in which the Company has variable interests (implicit and explicit), we have provided all information about events and changes in circumstances that could potentially cause reconsideration about whether the entities are VIEs or whether the Company is the primary beneficiary or has a significant variable interest in the entity.* *We have made and continue to make exhaustive efforts to obtain information about entities in which the Company has an implicit or explicit interest but that were excluded from complete analysis under Financial Accounting Standards Board Interpretation (FIN) No. 46R,* **Consolidation of Variable Interest Entities – An Interpretation of ARB No. 51,** *due to lack of essential information to determine one or more of the following: whether the entity is a VIE, whether the Company is the primary beneficiary, or the accounting required to consolidate the entity.*
The work of a specialist has been used by the entity.	*We agree with the findings of specialists in evaluating the [*describe assertion*] and have adequately considered the qualifications of the specialist in determining the amounts and disclosures used in the financial statements and underlying accounting records. We did not give or cause any instructions to be given to specialists with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an impact on the independence or objectivity of the specialists.*

Assets

Condition	*Illustrative Examples*
Cash ***Disclosure is required of compensating balances or other arrangements involving restrictions on cash balances, line of credit, or similar arrangements.***	***Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances, line of credit, or similar arrangements have been properly disclosed.***
Financial Instruments ***Management intends to and has the ability to hold to maturity debt securities classified as held-to-maturity.***	***Debt securities that have been classified as held-to-maturity have been so classified due to the company's intent to hold such securities to maturity and the company's ability to do so. All other debt securities have been classified as available-for-sale or trading.***
Management considers the decline in value of debt or equity securities to be temporary.	***We consider the decline in value of debt or equity securities classified as either available-for-sale or held-to-maturity to be temporary.***
Management has determined the fair value of significant financial instruments that do not have readily determinable market values.	***The methods and significant assumptions used to determine fair values of financial instruments are as follows: [*****describe methods and significant assumptions used to determine fair values of financial instruments*****]. The methods and significant assumptions used result in a measure of fair value appropriate for financial statement measurement and disclosure purposes.***
There are financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk.	***The following information about financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk has been properly disclosed in the financial statements:*** ***1. The extent, nature, and terms of financial instruments with off-balance-sheet risk*** ***2. The amount of credit risk of financial instruments with off-balance-sheet risk and information about the collateral supporting such financial instruments*** ***3. Significant concentrations of credit risk arising from all financial instruments and information about the collateral supporting such financial instruments***
Receivables ***Receivables have been recorded***	***Receivables recorded in the financial statements represent valid claims against debtors for sales or other charges arising***

in the financial statements.	*on or before the balance-sheet date and have been appropriately reduced to their estimated net realizable value.*
Inventories *Excess or obsolete inventories exist.*	*Provision has been made to reduce excess or obsolete inventories to their estimated net realizable value.*
Investments *There are unusual considerations involved in determining the application of equity accounting.*	*[*For investments in common stock that are either nonmarketable or of which the entity has a 20 percent or greater ownership interest, select the appropriate representation from the following:*]* • *The equity method is used to account for the company's investment in the common stock of [*investee*] because the company has the ability to exercise significant influence over the investee's operating and financial policies.* • *The cost method is used to account for the company's investment in the common stock of [*investee*] because the company does not have the ability to exercise significant influence over the investee's operating and financial policies.*
Deferred Charges *Material expenditures have been deferred.*	*We believe that all material expenditures that have been deferred to future periods will be recoverable.*
Deferred Tax Assets *A deferred tax asset exists at the balance-sheet date.*	*The valuation allowance has been determined pursuant to the provisions of FASB Statement No. 109,* Accounting for Income Taxes, *including the company's estimation of future taxable income, if necessary, and is adequate to reduce the total deferred tax asset to an amount that will more likely than not be realized. [*Complete with appropriate wording detailing how the entity determined the valuation allowance against the deferred tax asset.*]* *or* *A valuation allowance against deferred tax assets at the balance-sheet date is not considered necessary because it is more likely than not the deferred tax asset will be fully realized.*

Liabilities

Condition	*Illustrative Examples*
Debt *Short-term debt could be refinanced on a long-term basis and management intends to do so.*	*The company has excluded short-term obligations totaling $[*amount*] from current liabilities because it intends to refinance the obligations on a long-*

	*term basis. [***Complete with appropriate wording detailing how amounts will be refinanced as follows:***]* • ***The Company has issued a long-term obligation [*****debt security*****] after the date of the balance sheet but prior to the issuance of the financial statements for the purpose of refinancing the short-term obligations on a long-term basis.*** • ***The Company has the ability to consummate the refinancing, by using the financing agreement referred to in Note [*****X*****] to the financial statements.***
Tax-exempt bonds have been issued.	***Tax-exempt bonds issued have retained their tax-exempt status.***
Taxes ***Management intends to reinvest undistributed earnings of a foreign subsidiary.***	***We intend to reinvest the undistributed earnings of [*****name of foreign subsidiary*****].***
Contingencies ***Estimates and disclosures have been made of environmental remediation liabilities and related loss contingencies.***	***Provision has been made for any material loss that is probable from environmental remediation liabilities associated with [*****name of site*****]. We believe that such estimate is reasonable based on available information and that the liabilities and related loss contingencies and the expected outcome of uncertainties have been adequately described in the company's financial statements.***
Agreements may exist to repurchase assets previously sold.	***Agreements to repurchase assets previously sold have been properly disclosed.***
Pension and Postretirement Benefits ***An actuary has been used to measure pension liabilities and costs.***	***We believe that the actuarial assumptions and methods used to measure pension liabilities and costs for financial accounting purposes are appropriate in the circumstances.***
There is involvement with a multiemployer plan.	***We are unable to determine the possibility of a withdrawal liability in a multiemployer benefit plan.*** ***or*** ***We have determined that there is the possibility of a withdrawal liability in a multiemployer plan in the amount of $[*****XX*****].***
Postretirement benefits have been	***We do not intend to compensate for the elimination***

eliminated.	*of postretirement benefits by granting an increase in pension benefits.* *or* *We plan to compensate for the elimination of postretirement benefits by granting an increase in pension benefits in the amount of $[*XX*].*
Employee layoffs that would otherwise lead to a curtailment of a benefit plan are intended to be temporary.	*Current employee layoffs are intended to be temporary.*
Management intends to either continue to make or not make frequent amendments to its pension or other postretirement benefit plans, which may affect the amortization period of prior service cost, or has expressed a substantive commitment to increase benefit obligations.	*We plan to continue to make frequent amendments to its pension or other postretirement benefit plans, which may affect the amortization period of prior service cost.* *or* *We do not plan to make frequent amendments to its pension or other postretirement benefit plans.*

Equity

Condition	***Illustrative Example***
There are capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements.	*Capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements have been properly disclosed.*

Income Statement

Condition	***Illustrative Example***
There may be a loss from sales commitments.	*Provisions have been made for losses to be sustained in the fulfillment of or from inability to fulfill any sales commitments.*
There may be losses from purchase commitments.	*Provisions have been made for losses to be sustained as a result of purchase commitments for inventory quantities in excess of normal requirements or at prices in excess of prevailing market prices.*
Nature of the product or industry indicates the possibility of undisclosed sales terms.	*We have fully disclosed to you all sales terms, including all rights of return or price adjustments and all warranty provisions.*

Appendix I

Analytical Procedures the Accountant May Consider Performing When Conducting a Review of Financial Statements in a Review Engagement

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Analytical procedures are designed to identify relationships and individual items that appear to be unusual and that may reflect a material misstatement of the financial statements. The analytical procedures performed in a review of financial statements are a matter of the accountant's professional judgment. In determining the appropriate analytical procedures, an accountant may consider (a) the nature and materiality of the items reflected in the financial statements, (b) the likelihood of a misstatement in the financial statements, (c) knowledge obtained during current and previous engagements, (d) the stated qualifications of the entity's accounting personnel, (e) the extent to which a particular item is affected by management's judgment, and (f) inadequacies in the entity's underlying financial data.

The following list of analytical procedures is for illustrative purposes only. These analytical procedures will not necessarily be applicable in every review engagement, nor are these analytical procedures meant to be all-inclusive. These illustrative analytical procedures are not intended to serve as a program or checklist to be utilized in performing a review engagement. Examples of analytical procedures an accountant may consider performing in a review of financial statements include:

> Comparing financial statements with statements for comparable prior period(s).
>
> Comparing current financial information with anticipated results, such as budgets or forecasts (for example, comparing tax balances and the relationship between the provision for income taxes and pretax income in the current financial information with corresponding information in (a) budgets, using expected rates, and (b) financial information for prior periods).[1]
>
> Comparing current financial information with relevant nonfinancial information.
>
> Comparing ratios and indicators for the current period with expectations based on prior periods, for example, performing gross profit analysis by product line and operating segment using elements of the current financial information and comparing the results with corresponding information for prior periods. Examples of key ratios and indicators are the current ratio, receivables turnover or days' sales outstanding, inventory turnover, depreciation to average fixed assets, debt to equity, gross profit percentage, net income percentage, and plant operating rates.
>
> Comparing ratios and indicators for the current period with those of entities in the same industry.
>
> Comparing relationships among elements in the current financial information with corresponding relationships in the financial information of prior periods, for example, expense by type as a percentage of sales, assets by type as a percentage of total assets, and percentage of change in sales to percentage of change in receivables.

Analytical procedures may include such statistical techniques as trend analysis or regression analysis and may be performed manually or with the use of computer-assisted techniques.

~~In addition, the accountant may find the guidance in SAS No. 56, *Analytical Procedures* [AU section 329], as amended, useful in conducting a review of financial statements.~~

[1] The accountant should exercise caution when comparing and evaluating current financial information with budgets, forecasts, or other anticipated results because of the inherent lack of precision in estimating the future and the susceptibility of such information to manipulation and misstatement by management to reflect desired results.

Appendix J

Sources of Generally Accepted Accounting Principles

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Accountants agree on the existence of a body of generally accepted accounting principles, and they are knowledgeable about these principles and in the determination of their general acceptance. Nevertheless, the determination that a particular accounting principle is generally accepted may be difficult because no single reference source exists for all such principles. The sources of generally accepted accounting principles are:

a. Accounting principles promulgated by a body designated by the AICPA Council to establish such principles, pursuant to rule 203 [ET section 203.01] of the AICPA Code of Professional Conduct. Rule 203 [ET section 203.01] provides that an accountant should state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles or state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles unless, due to unusual circumstances, adherence to the pronouncements would make the statements misleading. Rule 203 [ET section 203.01] implies that application of officially established accounting principles almost always results in the fair presentation of financial position, results of operations, and cash flows, in conformity with generally accepted accounting principles. Nevertheless, rule 203 [ET section 203.01] provides for the possibility that literal application of such a pronouncement might, in unusual circumstances, result in misleading financial statements.

b. Pronouncements of bodies, composed of expert accountants, that deliberate accounting issues in public forums for the purpose of establishing accounting principles or describing existing accounting practices that are generally accepted, provided those pronouncements have been exposed for public comment and have been cleared by a body referred to in category (*a*).[1]

c. Pronouncements of bodies, organized by a body referred to in category (*a*) and composed of expert accountants, that deliberate accounting issues in public forums for the purpose of interpreting or establishing accounting principles or describing existing accounting practices that are generally accepted, or

[1] For purposes of this section, the word *cleared* means that a body referred to in subparagraphs (*a*) has indicated that it does not object to the issuance of the proposed pronouncement.

pronouncements referred to in category (*b*) that have been cleared by a body referred to in category (*a*) but have not been exposed for public comment.

d. Practices or pronouncements that are widely recognized as being generally accepted because they represent prevalent practice in a particular industry, or the knowledgeable application to specific circumstances of pronouncements that are generally accepted.

Generally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their substance. The accountant should consider whether the substance of transactions or events differs materially from their form.

If the accounting treatment of a transaction or event is not specified by a pronouncement covered by rule 203 [ET section 203.01], the accountant should consider whether the accounting treatment is specified by another source of established accounting principles. If an established accounting principle from one or more sources in category (*b*), (*c*), or (*d*) is relevant to the circumstances, the accountant should be prepared to justify a conclusion that another treatment is generally accepted. If there is a conflict between accounting principles relevant to the circumstances from one or more sources in category (*b*), (*c*), or (*d*), the accountant should follow the treatment specified by the source in the higher category—for example, follow category (*b*) treatment over category (*c*)—or be prepared to justify a conclusion that a treatment specified by a source in the lower category better presents the substance of the transaction in the circumstances.

The accountant should be aware that the accounting requirements adopted by regulatory agencies for reports filed with them may differ from generally accepted accounting principles in certain respects.

.Because of developments such as new legislation or the evolution of a new type of business transaction, there sometimes are no established accounting principles for reporting a specific transaction or event. In those instances, it might be possible to report the event or transaction on the basis of its substance by selecting an accounting principle that appears appropriate when applied in a manner similar to the application of an established principle to an analogous transaction or event.

Application to Nongovernmental Entities

For financial statements of entities other than governmental entities—

a. Category (*a*), officially established accounting principles, consists of Financial Accounting Standards Board (FASB) Statements of Financial Accounting Standards and Interpretations, Accounting Principles Board (APB) Opinions, and AICPA Accounting Research Bulletins.

b. Category (*b*) consists of FASB Technical Bulletins and, if cleared[2] by the FASB, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position.

c. Category (*c*) consists of AICPA Accounting Standards Executive Committee (AcSEC) Practice Bulletins that have been cleared[3] by the FASB and consensus positions of the FASB Emerging Issues Task Force.

d. Category (*d*) includes AICPA accounting interpretations and implementation guides ("Qs and As") published by the FASB staff, and practices that are widely recognized and prevalent either generally or in the industry.

In the absence of a pronouncement covered by rule 203 [ET section 203.01] or another source of established accounting principles, the accountant performing the compilation or review of financial statements of entities other than governmental entities may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes, for example, FASB Statements of Financial Accounting Concepts; AICPA Issues Papers; International Accounting Standards of the International Accounting Standards Committee; Governmental Accounting Standards Board (GASB) Statements, Interpretations, and Technical Bulletins; Federal Accounting Standards Advisory Board (FASAB) Statements, Interpretations, and Technical Bulletins; pronouncements of other professional associations or regulatory agencies; Technical Information Service Inquiries and Replies included in AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles. The appropriateness of other accounting literature depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, FASB Statements of Financial Accounting Concepts would normally be more influential than other sources in this category.

Application to State and Local Governmental Entities

For financial statements of state and local governmental entities[4] —

a. Category (*a*), officially established accounting principles, consists of GASB Statements and Interpretations, as well as AICPA and FASB pronouncements specifically made applicable to state and local governmental entities by GASB Statements or Interpretations. GASB Statements and Interpretations are

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[2] The accountant should assume that such pronouncements have been cleared by the FASB unless the pronouncement indicates otherwise.

[3] The accountant should assume that such pronouncements have been cleared by the FASB unless the pronouncement indicates otherwise.

[4] State and local governmental entities include public benefit corporations and authorities; public employee retirement systems; and governmental utilities, hospitals and other health care providers, and colleges and universities.

periodically incorporated in the *Codification of Governmental Accounting and Financial Reporting Standards*.

b. Category (*b*) consists of GASB Technical Bulletins and, if specifically made applicable to state and local governmental entities by the AICPA and cleared[5] by the GASB, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position.

c. Category (*c*) consists of AICPA AcSEC Practice Bulletins if specifically made applicable to state and local governmental entities and cleared[6] by the GASB, as well as consensus positions of a group of accountants organized by the GASB that attempts to reach consensus positions on accounting issues applicable to state and local governmental entities. [7]

d. Category (*d*) includes implementation guides ("Qs and As") published by the GASB staff, as well as practices that are widely recognized and prevalent in state and local government.

In the absence of a pronouncement covered by rule 203 [ET section 203.01] or another source of established accounting principles, the accountant of compiled or reviewed financial statements of state and local governmental entities may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes, for example, GASB Concepts Statements; the pronouncements referred to in categories (*a*) through (*d*) above when not specifically made applicable to state and local governmental entities either by the GASB or by the organization issuing them; FASB Concepts Statements; FASAB Statements, Interpretations, Technical Bulletins, and Concepts Statements; AICPA Issues Papers; International Accounting Standards of the International Accounting Standards Committee; pronouncements of other professional associations or regulatory agencies; Technical Information Service Inquiries and Replies included in AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles. The appropriateness of other accounting literature depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, GASB Concepts Statements would normally be more influential than other sources in this category.

Application to Federal Governmental Entities

For financial statements of federal governmental entities[8] —

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[5] The accountant should assume that such pronouncements specifically made applicable to state and local governments have been cleared by the GASB unless the pronouncement indicates otherwise.

[6] The accountant should assume that such pronouncements specifically made applicable to state and local governments have been cleared by the GASB unless the pronouncement indicates otherwise.

[7] As of the date of this appendix, the GASB had not organized such a group.

[8] Federal Accounting Standards Advisory Board (FASAB) Concepts Statement No. 2, *Entity and Display*, defines federal governmental entities.

a. Category (*a*), officially established accounting principles, consists of Federal Accounting Standards Advisory Board (FASAB) Statements and Interpretations, as well as AICPA and FASB pronouncements specifically made applicable to federal governmental entities by FASAB Statements or Interpretations. FASAB Statements and Interpretations will be periodically incorporated in a publication by the FASAB.

b. Category (*b*) consists of FASAB Technical Bulletins and, if specifically made applicable to federal governmental entities by the AICPA and cleared by the FASAB, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position. [9]

c. Category (*c*) consists of AICPA AcSEC Practice Bulletins if specifically made applicable to federal governmental entities and cleared by the FASAB, as well as Technical Releases of the Accounting and Auditing Policy Committee of the FASAB.

d. Category (*d*) includes implementation guides published by the FASAB staff, as well as practices that are widely recognized and prevalent in the federal government.

In the absence of a pronouncement covered by rule 203 [ET section 203.01] or another source of established accounting principles, the accountant of compiled or reviewed financial statements of a federal governmental entity may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes, for example, FASAB Concepts Statements; the pronouncements referred to in categories (*a*) through (*d*) above when not specifically made applicable to federal governmental entities by the FASAB; FASB Concepts Statements; GASB Statements, Interpretations, Technical Bulletins, and Concepts Statements; AICPA Issues Papers; International Accounting Standards of the International Accounting Standards Committee; pronouncements of other professional associations or regulatory agencies; Technical Information Service Inquiries and Replies included in AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles. The appropriateness of other accounting literature depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, FASAB Concepts Statements would normally be more influential than other sources in this category.

3. This amendment is effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007. Early application would be permitted.

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[9] The accountant should assume that such pronouncements specifically made applicable to federal governmental entities have been cleared by the FASAB, unless the pronouncement indicates otherwise.

Amendment to AR Section 200, *Reporting on Comparative Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 200.05)

4. AR section 200, *Reporting on Comparative Financial Statements,* as amended, establishes standards for reporting on comparative financial statements of a nonpublic entity when financial statements of one or more periods presented have been compiled and reported on or reviewed in accordance with AR section 100. This amendment revises AR section 200 by eliminating all references to auditing literature and, where deemed appropriate, incorporating guidance similar to that originally referenced.

5. New language is shown in boldface italics; deleted language is shown by strikethrough.

   .05 Compiled financial statements that omit substantially all of the disclosures required by generally accepted accounting principles[4] are not comparable to financial statements that include such disclosures. Accordingly, the accountant should not issue a report on comparative financial statements when statements for one or more, but not all, of the periods presented omit substantially all of the disclosures required by generally accepted accounting principles. (See paragraphs .30 and .31 for guidance on reporting on financial statements that previously did not omit substantially all of the disclosures required by generally accepted accounting principles.)

   [4] For purposes of this ~~s~~***S***tatement, reference to generally accepted accounting principles includes, where applicable, a comprehensive basis of accounting other than generally accepted accounting principals as defined in ~~SAS No. 62, paragraph 4 [AU section 623.04]~~ ***AR section 100.04***.

6. This amendment is effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007. Early application would be permitted.

Amendment to AR Section 300, *Compilation Reports on Financial Statements Included in Certain Prescribed Forms* (AICPA, *Professional Standards*, vol. 2, AR sec. 300.01)

7. AR section 300, *Compilation Reports on Financial Statements Included in Certain Prescribed Forms*, as amended, amends AR section 100 and AR section 200 to provide for an alternative form of standard compilation report when a prescribed form or related instructions call for departure from generally accepted accounting principles by specifying a measurement principle not in conformity with generally accepted accounting principles or by failing to request the disclosures required by generally accepted accounting principles. This amendment revises AR section 300 by eliminating all references to auditing literature and, where deemed appropriate, incorporating guidance similar to that originally referenced.

8. New language is shown in boldface italics; deleted language is shown by strikethrough.

.01 The requirements of ~~SSARS No. 1~~ ***AR*** ~~[~~section 100~~]~~ and ~~SSARS No. 2~~ ***AR*** ~~[~~section 200~~]~~ are applicable when the unaudited financial statements of a nonpublic entity are included in a prescribed form. This statement amends ***AR*** ~~[~~section 100~~]~~ and ~~SSARS No. 2~~ ***AR*** ~~[~~section 200~~]~~ to provide for an alternative form of standard compilation report when the prescribed form or related instructions call for departure from generally accepted accounting principles by specifying a measurement principle not in conformity with generally accepted accounting principles or by failing to request the disclosures required by generally accepted accounting principles.[1] This ~~s~~***S***tatement also provides additional guidance applicable to reports on financial statements included in a prescribed form.~~2~~

[1] For purposes of this ~~s~~***S***tatement, reference to generally accepted accounting principles includes, where applicable, a comprehensive basis of accounting other than generally accepted accounting principles as defined in ~~SAS No. 62, paragraph 4 [AU section 623.04]~~ ***AR section 100.04***. Disclosure of the basis of accounting should be made when a comprehensive basis of accounting other than generally accepted accounting principles is used.

[2] This statement amends ~~SSARS No. 1[~~***AR*** section 100~~]~~ in four places. The following sentences are added to the end of ~~paragraph 15 of SSARS No. 1[~~***AR*** section 100.15~~]~~:

> Also, an accountant may be asked to compile financial statements included in a prescribed form that calls for departure from generally accepted accounting principles. ~~SSARS No. 3 [~~***AR*** section 300~~]~~ provides additional guidance, including an alternative form of standard report, applicable to such compilation engagements.

The following sentence is added to the end of ~~footnote 18, paragraph 16 of SSARS No. 1, as amended [~~***AR*** section 100.16, footnote 18~~]~~:

> However, see ~~SSARS No. 3 [~~***AR*** section 300~~]~~ for guidance when such financial statements are included in a prescribed form and the prescribed form or related instructions do not request the disclosures required by generally accepted accounting principles.

The following is added as the penultimate sentence of ~~paragraph 46 of SSARS No. 1, as amended [~~***AR*** section 100.46~~]~~:

> ~~SSARS No. 3 [~~***AR*** section 300~~]~~ provides guidance when the departure is called for by a prescribed form or related instructions.

The following is added as a footnote to the last sentence of ~~paragraph 2 of SSARS No. 1 [~~***AR*** section 100.02~~]~~:

> ~~SSARS No. 3 [~~***AR*** section 300~~]~~ permits an accountant who has reviewed the financial statements of a nonpublic entity to issue a compilation report on financial statements for the same period that are included in a prescribed form that calls for departure from generally accepted accounting principles.

This statement also amends ***AR section 200.02, footnote 3*** ~~SSARS No. 2~~ by adding the following sentence ~~to footnote 3, paragraph 2 [section 200.02, footnote 3]~~:

> See ~~SSARS No. 3 [~~***AR*** section 300~~]~~ for additional guidance when the accountant compiles comparative financial statements included in a prescribed form that calls for departure from generally accepted accounting principles or, where applicable, from a comprehensive basis of accounting other than generally accepted accounting principles.

9. This amendment is effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007. Early application would be permitted.

Amendment to AR Section 400, *Communications Between Predecessor and Successor Accountants* (AICPA, *Professional Standards*, vol. 2, AR sec. 400.09)

10. AR section 400, *Communications Between Predecessor and Successor Accountants*, as amended, provides guidance on communications between a predecessor and successor accountant when the successor accountant decides to communicate with the predecessor accountant regarding acceptance of an engagement to compile or review the financial statements of a nonpublic entity. This amendment revises AR section 400 by eliminating all references to auditing literature and, where deemed appropriate, incorporating guidance similar to that originally referenced.

11. New language is shown in boldface italics; deleted language is shown by strikethrough.

> .09 The successor accountant should not make reference to the report or work of a predecessor accountant in his or her own report, except as specifically permitted by ~~SSARS No. 2 [~~***AR*** section 200~~] or SAS No. 26 [AU section 504]~~ with respect to the financial statements of a prior period.

12. This amendment is effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007. Early application would be permitted.